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No. 91-1677

In the Supreme Court of the United States

OCTOBER TERM, 1991

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

KEYSTONE CONSOLIDATED INDUSTRIES, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY MEMORANDUM FOR THE PETITIONER

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The question presented is whether an employer sponsoring a defined benefit pension plan may discharge its funding obligations by contributing property to the plan. In the government's view, such a contribution is a prohibited "sale or exchange" of property under 26 U.S.C. 4975(c)(1), which is part of the Employee Retirement Income Security Act of 1974 (ERISA). "Respondent acknowledges that there is a conflict on this issue between the decision of the United States Court of Appeals for the Fifth Circuit in the case at bar * * * and the decision of the United States Court of Appeals for the Fourth Circuit in *Wood* v. *Commissioner*." Br. in Opp. 2. And nothing in the response to our petition for a writ of certiorari disputes our contention that the question

presented involves a recurring issue of considerable importance.

Respondent nevertheless contends that "it would be imprudent at this time for this Court to resolve the conflict," Br. in Opp. 3, for three reasons. There is no merit to those contentions. First, respondent suggests that the issue "might be resolved simply by the [Department of Labor's] exercise of its regulatory authority." Br. in Opp. 4. The Department of Labor has indicated its view that the transfer of property in satisfaction of a funding obligation is a "sale or exchange" under ERISA's prohibited transaction provisions. DOL Advisory Opinion 90-05A (Mar. 29, 1990); DOL Advisory Opinion 81-69A (July 28, 1981). The Fifth Circuit has nonetheless rejected that view, on the basis of the court's conclusion as to the necessary effect of another subsection of the statute, 26 U.S.C. 4975(f)(3). See Pet. App. 5a, 7a. Because the court's holding is based on its interpretation of what the statute itself specifies, there is no reason to believe that adoption of a regulation would persuade the court to change its view.

Respondent next argues that review is unwarranted because the Fourth Circuit's decision in *Wood* upholding the government's position "was issued only two weeks after the decision" in this case. Br. in Opp. 5. But the Fourth Circuit was aware of the court's decision in this case. It stated that it found itself "in disagreement with the reasoning of the Fifth Circuit's decision" in this case, Pet. App. 28a, and devoted much of its opinion to explaining the basis for its disagreement. In that circumstance, there is no reason to think that the Fourth Circuit is likely to recede from its position in light of the Fifth Circuit's analysis in this case. To the contrary,

the Fourth Circuit had the benefit of the Fifth Circuit's opinion, and it expressly disagreed with it.*

Respondent's third point, in essence, is that the court in this case was so clearly right, and the Fourth Circuit in *Wood* was so clearly wrong, that review is not warranted. The linchpin of that argument is respondent's contention that the Fourth Circuit, in applying the generally recognized meaning of "sale or exchange" under the Internal Revenue Code in interpreting Section

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* In the course of arguing that the conflict in the circuits is not "compelling" because *Wood* was issued shortly after the opinion in this case, Br. in Opp. 4, respondent notes that the 1988 version of IRS's Examination Guidelines Handbook stated that a contribution of property to a pension plan is not prohibited if the plan permits such contributions, *id.* at 5, citing Internal Revenue Service Manual, Examination Guidelines Handbook, H.B. 7(10)(54) §§ 320, 324(2) (July 15, 1988). In context, this statement is tempered by the example that follows, which states that employers may contribute stock to profit-sharing plans; such contributions are exempted from the prohibited transaction provisions by 29 U.S.C. 1107 and 1108. Furthermore, the Department of Labor, not IRS, has interpretive authority with respect to ERISA's prohibited transaction provisions. See Section 102 of Reorganization Plan No. 4 of 1978, 92 Stat. 3790. Moreover, the Handbook has been changed to advise IRS examiners that "even if the plan permits the contribution to be made in cash or in kind a prohibited transaction may still occur." Internal Revenue Service Manual, Examination Guidelines Handbook, H.B. 7(10)(54) §§ 320, 324.1(2) (Jan. 30, 1989). And in any event, as the Sixth Circuit stated with respect to the Handbook, "a guideline, adopted solely for the internal administration of the IRS, rather than for the protection of the taxpayer, does not confer any rights upon the taxpayer." *United States* v. *Will*, 671 F.2d 963, 967 (1982); see also *Schweiker* v. *Hansen*, 450 U.S. 785, 789 (1981) (the Social Security Administration's Claims Manual, "a 13-volume handbook for internal use by thousands of SSA employees," has "no legal force, and it does not bind the SSA").

4975(c)(1), "must have been unaware that *all* transfers of property from an employer to a plan, *whether voluntary or in satisfaction of a debt*, are treated as 'sales or exchanges' under the income tax laws." Br. in Opp. 8. According to respondent, that shows that Congress, by prohibiting contributions of encumbered property in 26 U.S.C. 4975(f)(3), did not expand the definition of "sale or exchange," as the Fourth Circuit concluded; that, in turn, fatally undermines the Fourth Circuit's construction of Section 4975(c)(1), in respondent's view, by rendering Section 4975(f)(3) superfluous.

Respondent overlooks the language of the statute. Section 4975(c)(1) prohibits a "sale or exchange * * * of any property between a plan and a disqualified person." A voluntary contribution of property to a defined contribution plan is not a "sale or exchange" between the plan and a disqualified person such as an employer. That is because, unlike the situation presented in this case and in *Wood*, where the contributions satisfied the employers' funding obligations to defined benefit plans, a voluntary contribution to a defined contribution plan is not made in exchange for anything from the plan. A voluntary contribution is a taxable event under the Internal Revenue Code because it constitutes an exchange between the employer and its employees. But Section 4975(c)(1) does not prohibit sales or exchanges between *employees* and employers, it prohibits sales or exchanges between *pension plans* and employers. Accordingly, the Fourth Circuit correctly concluded in *Wood* that Section 4975(f)(3) expands the scope of the prohibited transaction provision by barring voluntary contributions of encumbered property, and its holding in no way renders Section 4975(f)(3) superfluous.

For the foregoing reasons, as well as those stated in our petition, it is respectfully submitted that the petition for a writ of certiorari should be granted.

KENNETH W. STARR
Solicitor General

MAY 1992